



Bill C-59 Changes to the General Anti-Avoidance Rule

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The General Anti-Avoidance Rule (“GAAR”), as contained in section 245 of the *Income Tax Act* (the “ITA”), intends to combat abusive tax avoidance transactions while avoiding interference with legitimate transactions. Budget 2023 initially proposed a number of changes to the GAAR. Subsequently, Bill C-59, introduced on November 30, 2023, contains legislation to enact proposals originating from a number of sources, including the draft legislation released by the Department of Finance on April 29, 2022, pro-

posals announced in Budget 2023, draft legislation released August 4, 2023, and measures announced in the Fall Economic Statement. Bill C-59 generally maintains the GAAR approach set out in Budget 2023 and confirmed in the August 4 legislative proposals. For example, the definition of “avoidance transaction” remains unchanged from the version proposed in Budget 2023 and the August 4 proposals. However, significant changes have been introduced regarding the “economic substance” test and penalties.

Economic Substance Test

Generally, the GAAR only applies when there is a tax benefit, an avoidance transaction, and a misuse or abuse of tax rules. Where the GAAR is determined to apply, the consequences of an avoidance transaction will seek to deny the tax benefit that would otherwise be realized. Budget 2023 introduced a new economic substance interpretive rule to the “misuse or abuse” test. Budget 2023 provided that an avoidance transaction “significantly lacking in economic substance” “tends to indicate” there is misuse or abuse that can trigger the GAAR. In initial draft legislation released in August 2023, the

language used in proposed subsection 245(4.1) was that a transaction lacking in significant economic substance was “presumed” to be a misuse or abuse, not “deemed”. As such, it was a starting point for the GAAR analysis and a presumption that needed to be rebutted for the GAAR not to apply.

However, the legislation included in Bill C-59 reverts to the language used in Budget 2023, stating that if an avoidance transaction is significantly lacking in significant economic substance, “this is an important consideration that tends to indicate that the transactions result in a misuse under paragraph (4)(a) or an abuse under paragraph (4)(b).”

This amendment highlights a concern about insufficient consideration of the economic substance of transactions during GAAR analysis. It indicates a shift towards prioritizing the lack of economic substance as a significant factor in determining misuse or abuse, rather than altering the existing burden of proof on the Crown at the misuse or abuse stage. However, case law has consistently upheld that the onus of proving misuse or abuse falls on the Minister, not the taxpayer. The Explanatory Notes to Bill C-59 explicitly state that the change from “it is presumed” to “tends to indicate” aims to prevent the provision from “being interpreted simply as a procedural shifting of the onus to demonstrate misuse or abuse from the Crown to the taxpayer”. The Explanatory Notes go on to further state that “where there is a lack of economic substance, the starting point would be that there is a misuse or abuse”, and “depending on the relevant facts and law, other considerations may demonstrate that the transaction does not actually frustrate the rationale of the provisions.” Accordingly, it would appear that the Minister will continue to bear the burden of proof.

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Budget 2023 also introduced new subsection 245(4.2) of the ITA, which provides factors to consider when analyzing whether a transaction or series of transactions is significantly lacking in economic substance. The August 4 proposals included an additional enumerated factor regarding the use of an accommodation party to ensure that the chances to gain or profit and the risk of loss are neutral. Bill C-59 added a carve-out to this factor by excluding non-arm’s length taxpayers with economic interests that are adverse to those of the taxpayer. The Explanatory Notes clarify that this carve-out is intended for taxpayers who do not operate at arm’s length, but “may nonetheless operate separately from an economic point of view and may have interests or motivations that are largely unaligned” with the taxpayer in question. This change is particularly positive for taxpayers deemed to be non-arm’s length due to family ties.

Bill C-59 also clarifies that the “significantly lacking in economic substance” test applies to an avoidance transaction or “a series of transactions that includes the avoidance transaction.” The Explanatory Notes state that this change encourages assessment of the series as a whole to provide the best lens for interpretation, thereby avoiding inappropriate determinations. The Explanatory Notes further state that the test will “provide flexibility for a holistic and common-sense assessment of the relevant facts and circumstances.” However, this approach might lead to confusion among taxpayers regarding whether the provisions necessitate assessing individual transactions or the entire series, and if it’s the former, which specific transactions within the series are relevant. This will likely become a matter of future litigation, as it arguably contradicts one of the stated purposes of the GAAR,

which is to strike a balance between providing taxpayers with certainty in planning their affairs and safeguarding both the tax base and the fairness of the tax system.

Penalty

Budget 2023 proposed a penalty of 25% of the tax benefit (other than a tax benefit arising from the creation of unutilized tax attributes) for reportable and notifiable transactions not reported to the Minister. Bill C-59 explicitly includes 25% of both the increased amount of tax payable and the amount by which refundable tax credits are reduced resulting from the application of the GAAR.

Conclusion

The amendments to the economic substance test are proposed to apply to transactions that occur on or after January 1, 2024, whereas the amendments to the penalty provisions are proposed to apply either on January 1, 2024 or on the day Bill C-59 receives Royal Assent, whichever is later.

While it is still difficult to evaluate the impact of these changes on both individuals and small businesses, it is clear that the risk has increased with a penalty of up to 25% of the tax benefit. Taxpayers should seek professional advice on their tax planning strategies to avoid these penalties.